# ECONOMICS FOR EXECUTIVES

A SERIES OF STUDY-UNITS AND AN ACCOMPANYING SERVICE WHICH TOGETHER CONSTITUTE AN INTERPRETATION OF THE UNDERLYING PRINCIPLES OF ECONOMICS AND BUSINESS FOR MEN AND WOMEN IN PRACTICAL LIFE

EDITED BY

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AMERICAN CHAMBER OF ECONOMICS
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STUDY-UNIT XIX—ECONOMICS FOR EXECUTIVES

# RENT—LAND VALUES

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# Rent—Land Values

## I

## Introduction

MANY people are accustomed to lay both their own troubles and many of the troubles of society to the rapacity of landowners and to the activity of land speculators, holding that the latter not only raise the rent of houses, but also the prices of food, clothing, and many other things as well. Those who entertain such views appear to be confirmed in their belief by farmers, who attribute the price of their products to the high cost of their land or the high rent they have to pay, and by shopkeepers, who justify the prices of their goods in the same manner.

On the basis of the analysis suggested above, proposals are frequently made for fixing or limiting rents and land values by governmental authority. Yet it is one of the oldest of economic doctrines that high or low rents are not a cause but are a result of high or low prices of land-products, and that neither the government nor any other

agency can affect these prices by changing rents. It is essential that the business man grasp the principles on which this view is founded.

### *Rent, Land Values, and Reform*

A theory of rent lies at the basis of many proposals for social reform. Thus there are earnest defenders of the proposition that the progress of society, as shown by the increase in population and by the advance in methods of production, bring real gains only to the landowners. It does this by increasing the demand for the use of land, thus advancing rents and causing land to be more and more valuable. At the same time, it is said, the earnings of those who own no land, especially the wage-earners, are not increased in proportion to rents, so that a long look ahead discloses for the latter only increasing poverty, while the landowners are growing richer and richer through no effort on their own part.

### *The Remedy Proposed*

The remedy proposed is the application of a tax based on land values that would absorb for the uses of the state all the rent of land, which might then, it is said, be devoted to the service of the mass of the people. Or, if it should be decided not to take

*all* the rent in taxes, at least taxes might be so increased from time to time as to divert into the treasury future increases in rent. This idea has appealed to many thousands and has been widely advocated. The movement, called the Single Tax movement, is probably not so strong as it was a generation ago, but it still has many devoted adherents and deserves attention on its merits. Much light will be thrown on it by the following study.

We shall begin by considering the nature of rent and describing the economic functions which it performs. The relation between land rents and land values will next be considered, leading up, in conclusion, to a discussion of the public regulation of land rents and land values.

## II

## The Function of Rent

Rent is technically defined as the price of the use of land. This price is quoted in the form of a rate, as $10 per acre per year. There are other prices quoted in the same way, as $3 per hour for the use of an automobile, or $1000 per day for the use of an ocean steamship. There is no practical rea-

son why these prices also should not be called rents, as indeed they often are; but there is a good scientific reason for calling them by different names, as for instance by saying that land is rented, while a house or an automobile is "hired."

### *A Useful Distinction*

The application of the term "rent" to the total compensation for the use of real estate, including capital invested in buildings and improvements of all kinds, although commonly practiced and unobjectionable in its place, leads to much confusion and a distinction even in this case is advantageous. Thus among economists, a house is technically known as capital, and is "hired," while the site on which it stands is technically known as land, and is "rented," because the same cause operates differently on the prices of the uses to which each may be put, and so on their *values*. An increase of population, for instance, is likely to *increase* the rent and value of land, since it is impossible to manufacture new land in any quantity; it may, however, *decrease* the "rent" (or hire) of houses, because new ways of building them in quantities may be discovered, reducing production costs and so lowering the price of their annual uses. The "rent" of automobiles is an even better illustration.

The phenomenon of rent is produced by the same causes that account for the existence of any other price, such as $1 a bushel for potatoes, or $5 a day for the services of carpenters. There is a limited amount of land, especially good land, just as there is a limited amount of commodities. Over against this limited amount of land there is an unlimited human need. All the land, or at least all the good land desirably located, is wanted—for standing room, for homes, for roads and streets, for sites for business places, like factories and stores, for parks, for farms. There is even then "not enough to go round." Not everybody can have as much of the use of land as he wants, and some pieces are wanted more than others. How is it determined, then, how much land each one shall have a chance to use and who shall have the particular tracts for which there are rival claimants? The method universally adopted is by the market, through competitive bidding, just as in the case of potatoes, or farm tractors, or the services of carpenters, and for the same reason.

### *Rent Promotes Social Economy*

The fact that the use of land bears a price in the form of rent serves a useful social purpose. It has been believed to be the most effective method of forcing a necessary

economy in the use of land. This means, of course, that those who can or will not make effective use of it are shut out of the market by reason of their inability to pay the price. Land which will raise a good crop of wheat will not be used for pasturage, and excellent house sites will not be used for farming. Those who are able and willing to pay the price usually are persons who are willing and able to use the land profitably, which means that they are able to raise a crop which will sell at the market price and still leave something over and above their expenses, including the rent they pay. Land tends to pass into the hands of the people who are able to get the highest values out of it, and society gains by such distribution.

### *Rent Influenced by Other Agencies*

Economy in the use of land does not stand by itself, nor does rent stand by itself, for, as has been explained in earlier study-units, the production of everything requires the use of four agencies in combination—land, labor, and capital working under the direction of enterprise. The most economical way of getting things done requires that all these factors be combined in the right proportions, although the proportions within limits may be varied, and certain amounts of one factor may be substituted for another. The eco-

nomic law or principle involved has been referred to before; it goes by either of two names—the principle of substitution or the law of proportionality.

*Rent and the Law of Proportionality*

Appreciation of this principle is fundamental to the understanding of rent. Thus a farmer who wishes to increase the size of his crop may do so, within limits, either by using more land or by employing more men or by making use of more machinery, fertilizers, or other kinds of capital goods. In other words, he can "substitute" men for land, land for capital, capital for land, and so on, and yet obtain the same amount of produce. The *price* which he has to pay for the use of each of these factors, as we noted in the study-unit, "The Organizing Functions of Prices," determines very largely whether he will use more of one factor and less of another. Wherever land is scarce and dear, the farmer will not waste it, but will use proportionally less land and proportionally more labor and capital. Such is the situation in congested countries like Holland and Belgium, where intensive methods of farming are in use; that is, methods which employ comparatively large quantities of labor and capital per acre. In other places, such as Australia and parts of the United States,

land is comparatively abundant while labor and even capital are comparatively scarce. In such places extensive methods of cultivation are employed, which means that comparatively small quantities of labor and capital are employed per acre.

### *Two Methods of Cultivation*

Under certain conditions the extensive method of cultivation is economical, while under certain other conditions the same advantage is possessed by the intensive method.

There is a curious misapprehension about what constitutes effective methods of agriculture which is at once dispelled when the operation of the principle of substitution is properly understood. Thus American farmers are sometimes subjected to criticism because they produce fewer bushels of grain per acre than are produced by European farmers. The criticism, of course, is mistaken, because American farmers, as a rule, have an abundance of land and consequently have not the same reason for trying to secure a maximum yield *per acre*. Their concern is to secure a maximum yield per dollar invested, which they can do by the use of extensive methods. Society's concern is to obtain the largest possible yield *per man*, which is here accomplished by the same method.

Professor Carver of Harvard University, who has written much on agricultural economics, notes that "as a matter of observed fact, intensive agriculture the world over is associated with the poverty of those who actually work on the soil." Its existence means that labor is cheap and land is dear. From the point of view of the consumer, of course, the American method produces farm products more cheaply in America; the European method more cheaply in Europe. The relationship between the supply of land and labor in European countries explains the poverty of farmers in the latter.

Similarly, it may be economical to utilize building sites in towns and cities either intensively or extensively. It would be foolish to build sky-scrapers in a country village and equally absurd to cover the island of Manhattan with two-story structures. The varying rentals of land in different localities insure the most efficient combination of land and capital, i.e., the proper proportion of investment as between building sites and buildirgs.

### *An Instance of Economic Law*

The process of substitution of one factor of production for another, to which we have alluded above, is constantly going on, as their relative prices change and as new technical

methods are developed. This is the fundamental reason why the increase of population, unless counteracted by other developments, tends to lower wages and to increase rents; it makes labor relatively more abundant, land relatively more scarce—two related effects which are registered in relatively higher rents and relatively lower wages. Such a change forces a more intensive use of land upon commercial and industrial society. The so-called "law of diminishing returns," whose application to land was explained in the study-unit on "The Primary Industries," is thus seen to underlie the principle of substitution as this is applied to all the factors of production.

### *Differences in Agricultural Rents*

We have explained how the rise and fall in the rent of land is related to the rise and fall in the prices of other factors of production. A word should now be said about differences in the rents of different pieces of land. How these differences come about is best seen by considering the situation of the farmer in his capacity as a business man.

The produce which comes from poor farms, i.e., farms that yield poorly in proportion to the labor of cultivation, will not sell for a higher price in the market than that coming from good farms. The farmer pos-

sessed of a good farm, therefore, has an advantage over his competitor on a poor farm, because he expends less effort per acre in order to get the same or a larger product. He has here the same sort of advantage that one factory has over another, but it flows in this particular instance from a different circumstance — that is, not from superior efficiency on his part, although he may *also* exhibit that and derive a profit from it, but rather from the fact that nature endowed his land more abundantly than that of his competitor. It "produces a surplus." Evidently the possession of such land is *worth* something to farmers who know how to use it, and their competition to secure it establishes higher rents or values for the better lands.

### *Proximity to Market*

Land which is close to market offers, of course, the same commercial advantage over land remote from market as good land offers over poor land. Crops can be brought to market at lower cost for cultivation and transportation (together) from farms that are nearby. This advantage is registered in higher rents for the better located lands.

It should not be supposed that rent exists only when one man uses the land of another and pays for it either in money or perhaps in a share of the crop. The farmer who

works his own farm must count a part of his income as rent on his land. He would arrive at the necessary figure partly by asking what he could afford to pay for the use of it if he did not happen to own it himself and partly by asking what others would pay him for it. Or he may get at it by subtracting from his total income the amount that he could get in wages for working somebody else's farm for him.

Probably very few farmers actually make this estimate because they have small occasion for making it, but if farm accounting were based on scientific economic principles there would be an advantage in reckoning by itself the part of the income that is due to the use of the land alone. Such a practice would enable farmers to make use of a scientific analysis of their costs in much the same way as manufacturers do.

### *Conclusions*

We have now reached the following conclusions as to the nature and function of rent:

Rent is the price of the use of land and must be distinguished from "rents" paid for producible commodities, since it follows different laws. All prices grow out of a limitation of supply, but the supply of producible commodities is limited by their cost of pro-

duction, while the supply of land is limited by nature. Since the supply of land is thus limited, an increase in the demand for it, as for example, through the growth of population, necessarily results in an increase in land rents, while this is not true of the rentals of things that can be manufactured, such as automobiles.

The existence of rent promotes social economy by helping to insure that the limited supply of land will be put to the most advantageous use, and that it will be combined with labor and capital in the most economical proportions under the principle of substitution.

Differences in the rents of different pieces of land tend to correspond to differences in fertility or desirability of location or both. Farmers who own their own land should reckon part of their incomes as rent, this being the equivalent of what they could get from another farmer for the use of their land.

## III

## Land Rents and Land Values

It is generally understood that there is some definite relation between the selling

value of land and the amount of its rent, but not everybody understands just what the relationship is. Is a man willing to pay $1000 for a piece of land because of the rent he can get for its use, or does he charge $50 a year rent because he had to pay $1000 for the land? Also, what determines the ratio of the two sums?

### *The Worth of Land*

We have seen that rent grows out of the natural scarcity of land and the amount of the rent is the result of the bidding by those who expect to use the land so as to earn more than the bare expenses of cultivation or improvement. The excess of the annual income that any piece of land will yield over and above the cost of capital and labor employed in its cultivation or improvement measures the worth to the owner of its annual use. This is what tenants will pay for such use. This is also the sum the owner should count as rent if he works the land himself, and if he wishes to sell his land outright the amount he can get for it will depend upon the value of its annual use—that is, upon its rent.

The competition of investors tends to establish a normal relation or ratio between the annual net rent of any piece of land and the market value of that land. Thus land yielding a net rent of $1000 and promising

to continue to do so, will tend to have a value of approximately $20,000 when the current rate of interest on comparable investments is 5 per cent. The English express this fact by saying that normally land is worth "twenty years purchase," meaning that the capital value is twenty times the annual income. Either a rise or fall in the rent or in the interest rate will, of course, occasion a proportional advance or fall in the value.

### *An Illustration*

For example, if the current rate of interest on such investments should happen to be 4 per cent, the value of land renting for $1000 would tend to be $25,000. This is in accord with the principle set forth in our discussion of interest, that *the capital value of a fixed monthly or annual income varies inversely with the rate of interest, or "the rate of capitalization."*

Capitalization, as used in this connection. is nothing but the name of an arithmetical calculation. The process of finding a capital sum which at a given rate of interest will yield a given income is a matter of mere arithmetic. But the process by which *the rate* is *established* is not a matter of arithmetic; it involves the operation of economic principles.

The rate at which the income from investments in land is capitalized, or the ratio between the income and the value, is commonly lower than the rate of return obtained on many other investments. It is sometimes as low as 4 per cent when good bonds are yielding 4½ per cent or even 5 per cent. The explanation for this fact lies chiefly in three peculiarities of land investments.

### *Peculiarities of Land Investment*

First, investments in land are among the safest of investments, especially in a new and developing country. The mass of the people, furthermore, are fully aware of this fact, while they know comparatively little about investments other than in real estate and mortgages. They are, therefore, disposed to distrust other investments, but have confidence in land, and in many cases buy it with a view to the safety of their principal rather than the rate of return. They will bid up the price of land to a point where it will pay a lower rate than would satisfy them in the case of any other class of investment.

### *Social Prestige*

Secondly, there is a certain social prestige attached to ownership of land. This fact in itself induces many people to prefer land investments to other investments irrespective

of the rate of return. It swells the demand for land in comparison with the demand for other investments, and tends to make its price somewhat "out of line." This consideration applies especially to such countries as England where ownership of land is almost a mark of aristocracy.

Thirdly, many people feel a sense of independence in the ownership of land which no other property can confer. Some want to own their own homes even if the costs, all told, exceed the rent they would have to pay. Such people swell the demand for land and enhance its price, tending to bring the latter "out of line" with the current rate of interest. Farmers in particular desire this feeling of independence and appear willing to pay something for it. This partly explains why so many farms change hands at figures which make their net income fall under 4 per cent.

### *The Income from Land*

As a business proposition, it is not difficult to determine what the right to receive the future income from a piece of land is actually worth, provided only that the investor or farmer can be *certain* of what the future income will be. This, however, is not always easy. In fact, it is often well nigh impossible to foresee how long the income will remain at any given figure. Much popular confu-

sion and some unnecessary bitterness arise from failure to appreciate this fact. A concrete instance taken from recent history will be worth citing at some length and analyzing in detail.

### *The Profits of Farmers*

The Farm Management Department of the Iowa State College of Agriculture in co-operation with the Iowa Farm Bureau Federation completed in the summer of 1920 the gathering of figures from a large number of typical Iowa farms on the cost of production of wheat. We quote from the report as follows:

> "The investigation of wheat costs was carried on in Montgomery, Warren and Wapello counties. Figures were secured from 167 farms. The average value per acre of the land in wheat was $282. The average yield was 18.5 bushels and the average acreage was 29.
>
> "Only 40 per cent of the 167 farms produced wheat at a cost of $1.80 or better, the present market price. *The remaining 60 per cent stand to lose on their wheat-growing operations this year.*
>
> "The cost of production for an acre of wheat was distributed as follows: Seed, $3.41; use of land, including taxes and 5½ per cent interest on land, $16.80; man labor, $4.14; horse labor, $5.04; machinery, $1.24; threshing, $1.67; twine, 35 cents; threshing fuel, 16 cents; manure, $1.49; storage, 44 cents; miscellaneous, $1.04."

The most interesting feature of this calculation is the cost of the land. It may well be that the figures represented average values when the calculation was made, and some of the present owners may have paid that price for the farms, but whether or not they are *now worth* that valuation depends upon the prices that can be obtained, now and in the future, for the products grown on them. If the average farm in this area may be expected to yield only 18.5 bushels of wheat per acre, which will sell at only $1.80 a bushel, and expenses other than rent and taxes continue at the figures above quoted, the income remaining from $33.30 is not enough to make it worth while to pay $282 for an average acre of such land. Even if it were tax-free, $260 would cover its value with the interest rate at 5½ per cent. It is reversing the actual relationship to represent land values as a basic element in the price of products. The converse is true—namely, land values are based upon the value of the products which the lands will produce. Since the value of these products fluctuates, however, it is not easy to estimate correctly the value of the land.

### *Land Values as a Factor in Costs*

Almost all farm management calculations, even those made by the government, include

interest on the estimated value of the land as part of the cost of making the crop, and as land values rise whenever crop values do, it follows that such calculations almost invariably show that there is no profit in farming operations.

This method of calculating costs may be justified for the purpose of showing individual farmers just where they stand, but as a basis for a grievance on the part of the farmers against the rest of the population, it is not valid. Figures showing that the farmer, after allowing interest on the value of his land does not receive adequate pay for his labor, do not actually prove that contention, nor do they prove that prices of products are too low; it may be that land values are rated too high.

### *Why Land Values Advance*

The Department of Agriculture issued in 1921 a pamphlet entitled "Farm Land Values in Iowa" in which it shows as the result of a careful inquiry that between March 1, 1919, and March 1, 1920, the selling value of farms in Iowa increased, on the average, $63 per acre. The Iowa State Census of 1915 calculated that during the ten years preceding, the average value of Iowa lands had increased $60.25 per acre, or 128 per cent. The report of the Federal

Census for the ten years 1899 to 1909, calculated the average advance during those years at 124 per cent. What caused these advances?

The report of the Department upon the sensational advance of 1919 to 1920 shows that in 1,035 farm sales which were investigated, 727 farms were bought by farmers, of whom, however, 47 are classed as retired farmers, living in towns. The other purchasers were people in various occupations, some of whom stated that they intended to live on the lands, while others bought with the intention of selling again. At bottom it is the efforts of farmers to buy farms which puts up the price. If there were no demand from the farmers there would be no demand from speculators. Upon what theory then can the farmers blame other people for the high price of lands, and what reason is there in the claim that the prices of farm products should advance to pay a return on any prices which the farmers may establish upon lands? If the prices of farm products should double, the scramble for farms would send values so high that the farmer would show just as poor earnings as before, according to the popular system of calculating costs. Judged from this standpoint the situation of the farmer is hopeless.

It is unfortunate that land values should

be lifted by temporary influences such as the high price of products in war time, that the rise should be assisted by speculation, and that people should go into debt to buy under such conditions; but the prospects of rising prices for any kind of property always cause speculation, and the right of people to go into debt is incidental to freedom in the management of their private affairs.

### *Influence of "Short Sellers" Lacking*

If an organized speculative market, such as exists for cotton, wheat, and securities, were possible in the case of land, such spectacular rises in land values as now occur would be less likely to occur. As has been explained in the study-unit on "The Financing of Production," the short-selling in an organized market exerts on the whole a stabilizing influence on prices. Unfortunately, acres of land are not identical with one another as are shares of stock, so that they cannot be sold "short," and all land speculators represent the "long" interest. There is likely, therefore, to be sudden rises in land values during a period of rising prices and an equally sudden fall afterwards. When the prices of products fall, and land values fall with them, the penalty of bad judgment is inflicted upon those who have misjudged the market.

The considerations bearing on the increase in land values from time to time and especially over long periods may now be summarized.

### *Reasons for Increase in Land Values*

The market price of land at any given time registers the opinions of many buyers and many sellers with reference to its prospective income. Land values, then, are not arbitrary, but express a composite judgment. They do not result from mere price manipulations by a few.

Some part of the increase in land values is due to the fact that buyers of land do not always follow strict business principles. They buy because they exaggerate the security of land investments or overestimate prospective income, or because they appreciate the independent position of landowners or their social prestige.

### *Supply of Land Limited*

Finally and fundamentally, the reason for the increase in land values from decade to decade and from century to century is due to the fact that land is something of which the stock cannot be increased. A growing population living on a fixed amount of land will increase the pressure on the land unless ways are discovered and brought into

use which make more effective use of it. Developments in transportation, which reduce the cost of bringing products to market from long distances, tend to spread out the demand for land, which amounts to almost the same thing as increasing the supply and consequently helps to keep down rents and land values. Improvements in the efficiency of agriculture, which result in increasing the yield per acre without proportionate increase in costs of cultivation, operate in the same direction. Two implications of this conclusion will bear special emphasis.

First, neither the rent of land nor the value of land nor yet the increase in these items is caused by "land monopoly." They are not the result of arbitrary or combined action. Land is not all owned by one man nor are landowners in effective combination. They are in fact in effective competition. Much popular antagonism to landowners overlooks this fact. The stock of land is limited by nature and not by man and consequently land values cannot be attributed to the "grasping greed of land monopoly."

### *Effect of Agricultural Efficiency*

Secondly, improvements in agricultural methods tend to lower rents and land values rather than to raise them.

At first sight, this proposition looks like

a paradox, because it would seem that as farmers increase their efficiency they would increase their profits, increase their demand for land and so raise its rent and its value. Such reasoning, however, overlooks the fact that an increase in the efficiency of farmers tends to show itself in an increase in the supply of farm products and a consequent fall in their prices, so that the money profits retained by the farming class tend to decline; they may stimulate demand for land for a time, but they cause no permanent increase in the demand for land, in its money rent, or in its money value. Farmers are in the same position as other business men who are forced by competition to share the benefits of their improved efficiency with the consuming public by the competitive lowering of prices. This does not mean that an individual farmer does not profit for a time by improving his methods, as does a manufacturer, but that eventually when these improvements become common to the farming class, the benefits go to consumers as a whole in the shape of lower prices.

### *The Farmers' Gains*

For this reason, farmers sometimes ask themselves what good it does the "farming class" to try to "make two blades of grass grow where one grew before," when the pur-

suit of such a policy by all of them would lower agricultural prices, and might even go so far as to cause reductions in the value of land. There is but one answer to this question. Farmers must look to corresponding improvements in the efficiency of other classes of society for their own permanent and substantial gains. Only when production along all lines is both abundant and well-balanced, with this balanced relation properly registered in prices, can all classes of producers share equitably in the advantages of economic progress.

### *Benefits to the Farmer*

Moreover, farmers are in a peculiarly advantageous position because they produce so many things that they themselves consume, and consequently every increase in their productive efficiency means a benefit to themselves as consumers. A manufacturer of locomotives, as a consumer, reaps advantage from the growing cheapness of his own produce only very slowly and indirectly. Even a shoe manufacturer cannot save a very considerable amount on account of cheapening the cost of shoes for himself and for his family. But a farmer who produces directly a large part of his "living," gains directly by being able to grow bigger crops and better livestock at less cost. It is often said that

while many farmers do not make any more money than they used to, they "live better" than they formerly did.

*Rise in American Land Values*

The average rent of farm land per acre, the world over, has probably not risen much within the last one hundred years. If this statement seems surprising, it is because we are so familiar in America with rising rents and rising land values. In America, as in all so-called new countries that have been brought into connection with the central markets of the world by the development of modern transportation, rents per acre have certainly increased. But on the other hand, rents in older countries have decreased, just as they decline in New Hampshire, for instance, when the railroads brought Illinois land into competition with New Hampshire land. They have declined, on the whole, in England.

The increase in land values in America, however, is very striking. Persons still living can remember when land now held at hundreds of dollars per acre was once sold by the government at $1.25 per acre. The increase in the average value per acre of the farms of the United States for the period 1850 to 1920 is shown by the table on the following page:

AVERAGE VALUE PER ACRE OF FARMS IN THE UNITED STATES

| Year | Value Per Acre |
|---|---|
| 1850 | $11.14 |
| 1860 | 16.32 |
| 1870 | 18.25 |
| 1880 | 19.02 |
| 1890 | 21.31 |
| 1900 | 19.81 |
| 1910 | 39.60 |
| 1920 | 69.38 |

This table shows that the average value per acre has increased from $11.14 in 1850 to $69.38 in 1920. The largest increases have been in the last two decades, during which the average value jumped 250 per cent. Although the actual increase may be exaggerated by these figures because they are based chiefly on valuations for assessment purposes, they still undoubtedly signify a decided rise in actual land values, as well as in assessed values.

### *Effects of Increased Land Values*

The social consequences of such an increase in land values as we have witnessed in this country are to be observed in two principal directions.

First, the rise in land values has been an important cause of the decrease in the average size of farms. The average number of

acres per farm decreased from 203 in 1850 to 146 in 1900, and to 138 in 1910. Farms of all sizes have increased in number since 1880, but the increase has been greatest for farms of under fifty acres in size. This change probably registers a drift toward more intensive cultivation. It means that each farmer is devoting more effort and care to fewer acres. He is economizing more in land and less in his own labor and management.

### *Tenant Farming*

Second, during the twenty years ending in 1910 or thereabouts, the significant movement of land values had resulted in an increase of tenant farming. During this period prices of farm products increased more rapidly than most other prices. This fact reflected itself in a rise in the value of farm land, which was far greater than the rise in the general price level. Such an increase in land values in the open country has made it more difficult for young farmers to secure farms of their own. Farm laborers may still become tenant farmers, but they cannot so easily graduate from that class into the class of owners. Thus the proportion of farms operated by owners was smaller in 1910 than in any earlier census year.

The conclusion of Professor R. T. Ely of

the University of Wisconsin, who has for many years given special study to this matter, is as follows:[1]

> "When land goes to $200 per acre, the average young farmer can neither save enough nor command enough credit to buy a farm of 160 acres and equip it properly. We shall have either more tenancy in the older sections of the country, as time passes, or smaller farms and a different type of agriculture. The latter change would probably do more good than harm in the end."

It is surely more desirable, as Professor Ely suggests, that we have in this country a widely diffused ownership of land by small, independent farmers rather than a general system of tenancy. Intensive farming is the natural and logical outcome of the growth and development of the country, and the sooner this is recognized the better for the people of both country and city.

### *Land Rents in Cities*

The rent of land in cities and the value of such land conforms in a general way to the same laws which hold in respect to farm lands. City lands command rent because they are scarce in proportion to the demand for them. There are never enough good

[1] Richard T. Ely, "Outlines of Economics." (Published by The Macmillan Company. Reprinted by permission.)

business blocks in a city to go around, never enough desirable residential sites to satisfy those who would like to have them. Hence those who are willing to pay the most get their choice. The different rents that are borne by different sites in the same city correspond to the differences of commercial or residential advantage afforded by them.

Business men in retail lines, of course, can usually afford to pay more for the use of a down-town site than for one on the outskirts of a city, because the concentration of purchasers down-town insures a larger volume of business there. So, also, a buying public which habitually purchases goods of any kind in large quantities from "corner stores" will make it so profitable for business men—say those selling cigars—to locate on such corners that they can outbid others for the corner locations. Sometimes the volume of business is not the sole factor in the matter, because consumers often prefer to buy at stores in convenient and stylish locations to such an extent that they will pay higher prices rather than put themselves to the trouble of shopping on side streets. Sixth Avenue shopkeepers in New York explain that they can sell at lower prices than the Fifth Avenue stores because they pay lower rents, but it is more accurate to say that their rents are low because they cannot get as

high prices on the same volume of goods as dealers on Fifth Avenue are able to get. If they could, Sixth Avenue rents would rise.

Wherever superior opportunities for profit are offered by superior locations, we may be sure the enterprise of business men will sooner or later discover the fact and that their competition for the sites in question will establish rents which correspond to the commercial advantages offered.

### *House Rents and Land Rents*

We are speaking here, of course, of land alone, not of houses and business buildings. Land for building purposes does not wear out, but houses do. If house rents fall below normal returns on the cost of production, the supply of houses will not be kept up and house rents will eventually rise. If such rents rise above normal, the reverse effect will follow and the supply will be increased. It is because of this difference in the conditions of supply, that land rents determine land values while house rents, and the rents of other producible things, are based on their costs. Houses are necessarily attached to land, however, and usually have to be rented, bought, and sold with it. House rents include, then, an element of return on capital investment which tends to vary with the cost of building houses, and an element of

land rent which depends upon the demand for that kind of land and also for the particular piece of land. Sometimes these two elements may be moving in the same direction, as in the cities during the war; sometimes in opposite direction, as in some country villages where house rents were maintained in spite of falling land values because of the rising cost of building.

# IV

# Regulation of Rent—Taxation of Land Values

Proper understanding of the theory of rent helps one to appreciate the character of proposals sometimes made for regulating rent by public authority or for appropriating rents wholly or in part by taxation.

### *Proposal for Limitation*

The government cannot do much to keep down the rent of land for the reason that the government can do very little to increase the supply of land or to decrease the demand for it. Any attempt to decree that the rent of land shall be so many dollars a year cannot accomplish its purpose if this figure departs very far from the one which would be set

by the free workings of supply and demand. If the figure is set too low, for example, there will be a number of people willing to pay something better than the regular rate and they will offer a premium to those who happen to have possession of land on the government's terms.

It is almost impossible to enforce such regulation, as it is to enforce the establishment of any price which does not equate supply and demand. Both landlords and tenants will try to evade the law by secret contracts. But if such regulations could be enforced, they would not remedy the scarcity of land. No more people than before could get the use of desirable plots. Moreover, those people who did get them would not necessarily be those who were willing to pay the most for them and were therefore likely to use them to the best advantage. The latter would not be permitted to outbid their competitors. Thus, if four men want a certain lot, one for a garden, one for a tennis court, one for a garage, and one for a house site, under ordinary conditions the one to whom it is worth the most will get it. But with a limitation set upon the rent, all might be willing to pay the established price, so that the ultimate purchaser would have to be determined on the basis of luck, or of favoritism on the part of the owner. The function

of rent in assuring that the limited supply of land will be most economically utilized is destroyed by regulation.

Another factor comes into play in connection with attempts to fix legal limits on house rents, as distinguished from ground rents. If such a law accomplished its primary purpose, its secondary consequence would be a falling off in building operations. This would be especially true if house rents were fixed at figures too low to make such operations profitable. The supply of houses would then be more limited than ever, with the result that enforcement of limitation upon rents would be more and more difficult, and the housing conditions of the population still more congested.

### *Taxing Away All Rent*

Instead of limiting rents by law, it is sometimes proposed that all or a very large part of all rents be absorbed by high taxes on land. The usual basis for the taxation of land is land value, and since land values result from the capitalization of rents, taxes on land are in proportion to the rent or income from land. These taxes take part of what would otherwise go to the owner as rent and it is quite reasonable that they should do so provided other incomes are taxed in the same proportion. But this

proposal of a "single tax" on ground rent is a different matter. It will be evident that if taxes were so high as to absorb the *whole* net income from land, there would be no inducement to pay anything for the right to own land. In short, this "single tax" proposal means that all rents would flow into the hands of the state so that the state would become virtually the sole owner of land and all private transactions for the transfer of land titles between private parties would cease. What may seem at first sight, therefore, to be a proposal for taxation is in reality a proposal for the reconstruction of society through the substitution of state for private ownership of land. This question of the desirability of public ownership of land will come up for consideration in a later study-unit, in which the whole institution of private property in relation to economic progress will be examined. It is important to note here, however, the real significance of the proposal to tax away all land rent—a significance which the advocates of the plan do not themselves always recognize.

### *Would it Make Land Free?*

The support that the proposal has received is due chiefly to the popular belief that it would in some mysterious way make land free to all, and so would relieve the

poor of their poverty. The simplicity of the idea makes it very appealing. There are few minds that cannot grasp the idea that free land would be a very desirable thing. When there is added the charge that land-owners have done nothing to produce their land and little to enhance its value and consequently have not earned the incomes they receive, the advocacy of the proposal takes on the cast of a righteous crusade. What the enthusiasts of the movement do not see is that the measures suggested will not accomplish what its advocates so much desire. Taxation or public ownership cannot make "free land."

The transfer of all land from private owners into the hands of the state would not serve to make land any more abundant, still less to make it so abundant that it would be absolutely free. In fact, there is no reason to suppose that such a change would make it any easier than it is now for a poor man to obtain the use of land. This conclusion takes on more force when we observe that there could scarcely be any workable method of determining who should have the use of land except the method of competitive bidding, with which we are at present familiar. According to this method rents paid to the government landlord could scarcely be far different from rents now paid to private

landlords because the change suggested would make no difference in the fundamental situation. Where there is little land and many people wanting it sufficiently to pay for it, values will be established at so high a figure as to put land out of the reach of the less capable or less fortunate.

### *Would Society be Enriched?*

We may also point out here that if the state took over all the lands and received all the rents, society would not necessarily be richer by that amount. Society is enriched only by production, and whether public ownership of all land would be advantageous or not would depend, as with the public ownership of industries, upon the public management of them. The public is interested in obtaining the largest possible results from the use of lands, as it is interested in obtaining the largest possible results from all the industries. Ownership gives control and permanency of tenure, and experience has favored the opinion that private ownership results in better care of land and larger returns from it than does any system of public ownership.

It does not follow because income flows into the treasury of the state instead of into private hands that the community as a whole is richer; it depends entirely upon how that

income is used. Wealth in private hands may be used more wisely, more productively, and with greater benefits to the public, than wealth paid into the public treasury. In this respect the income from land is no different from other incomes. The relative gain or loss to society from the appropriation of rents by the government depends upon the use which is made of this income compared with the use which private owners would make of it.

### *Taxing Away Increases in Rent*

Another proposal, less radical than the above, is to impose taxes on land from time to time which will be large enough to absorb *increases* in rent and so prevent the accumulation of the "unearned increment" of land values in private hands. This is quite in line with the orthodox theory of rent which has here been presented. It does not destroy private property rights in land already acquired, but forestalls the rise in land values which results from the growth of population and other causes for which the landowner is not responsible. Those who support this particular proposal have every right, therefore, to claim orthodox authority, and those who oppose it need not deny the fact. The latter, as a rule, are not even disposed to do so. Thus Professor Taussig,

of Harvard University, after stating that the proposal to appropriate *all* land values to the state is a very far reaching one, speaks as follows:[1]

> "A different proposal is that to appropriate not the whole of the unearned increment, but the *future accretions.* Let vested rights—the private ownership of land and the enjoyment of existing rents—remain undisturbed. But take for society at large the increase of rents that will arise hereafter. There can be no objection in principle to this proposal. The sole question is whether it will on the whole bring gain to the community."

He then continues:

> "With the rapid growth of modern cities and the unmistakable swelling of site rents, a reservation of the community's rights with respect to urban lands has met with steadily increasing recognition. The form in which this right is most likely to be asserted is that of a special tax on the newly accrued increase in site values. In strict theory, the whole of this increase might be taken through taxation."

There are clearly administrative difficulties in the face of such measures, like that of ascertaining the exact amount of the true

[1] F. W. Taussig, "Principles of Economics." (Published by The Macmillan Company. Reprinted by permission.)

or pure economic rent. Professor Taussig's own conclusion is given as follows:

> "I know not whether it will ever prove possible, under the present organization of society, to attain a really discriminating method of dealing with the problem. Though the principles which underlie it are among the most settled in the theory of economics, they bring a shock to the common notions about the sanctity and stability of real property; and their application involves a disturbance of the common ways of dealing with real property. The movement for taxing the unearned increment on urban sites is certain to grow in strength, and to bring results in legislation; but the precise mode in which it will proceed will be affected by compromises and half measures."

### *Reward for Risk*

The chief objection to levying special taxes on the increase in land values involves consideration of the theory of profits as well as the theory of rent. So far as farm lands are concerned, it is frequently pointed out that the lodestone which drew the pioneers into the wilderness and led them to improve it, was the hope of large profits from the ownership of the land. It was anticipated that as population grew, land values would increase, and the hope of these gains acted as an inducement for undergoing the privations which the early settlers endured. The same consideration applies, but with some-

what less force, to the improvement of farm land, even after it has been brought under cultivation. So far as city lands are concerned, it is a common practice where erecting buildings to count upon the probable appreciation of the land to offset the inevitable depreciation in the building due to use, the weather, and changing styles of construction and architecture. In such cases, the increase in land values is a part of the profit of building operations and acts as an incentive for carrying them on. Such operations are, of course, attended by risks, one of which is that the land on which the building is erected will fall in value. Some unforeseen movement of the population, the laying of a new car line, a change in location of a factory, may make the property decline instead of rise in value. Every large city affords instances of losses from previous land values. New York City has experienced them at every stage of the up-town movement of retail trade. The same phenomenon has been witnessed in farming lands. Some lands of the eastern states are not saleable for as much today as they were sixty or eighty years ago.

If the policy is adopted of appropriating the entire future increment to the state, the effect will be to confiscate a portion of present values, for nobody will want to hold land

when there is no chance for profit and some chance of loss, and the efforts to sell out will cause a decline of prices. There must be some return for risk upon investment in land as upon other investments if enterprise in improving land is to be encouraged. The chance of possible losses must be counterbalanced by the chance of possible gains. This is a general principle which was discussed more at length in the study-unit on "Profits and Other Incomes."

In fact, the proposal to tax away the unearned increment of land values is an attempt to appropriate but one of many types of "windfalls" which accrue to individuals without effort but which are associated with the possibility of equally undeserved losses. Whether these gains and losses can be more equitably distributed than at present in a more far-reaching and fundamental question than the mere problem of dealing with increases in land rent.

## V

## Conclusion

There has been much discussion, first and last, about the nature of economic laws and especially about whether these laws are

"natural" in any fundamental sense, or whether, on the other hand, they are tendencies only, which work in such a way that they are subject to modification by human action. The study of rent throws light upon the answer to this question.

It indicates that there are some respects in which human action can accomplish practically nothing, as, for instance, toward increasing the available amount of land or destroying altogether either the rent of land or its value.

So far as the present working of society is concerned, in which reliance is placed on private enterprise and the forces underlying supply and demand, there are strict limits to the extent to which the process can be interfered with from outside without causing considerable disorder and possibly courting disaster. We may well observe, however, that the whole system of private enterprise, private property, and the practice of permitting free dealings in commodities and in factors of production including land, is itself always subject to critical examination and continually called upon to justify itself by the way it promotes the common good.

Conservative opinion on the rent question, therefore, as on all other economic questions, will concern itself especially with the advantages flowing from social arrangements

which have been well-tried. Conservative effort, also, will be directed toward improving these arrangements in particular cases, such as those in which risk of experiment is comparatively slight, while the prospect of social gain is comparatively great.

Finally, there is need for hard thinking upon the part of anyone who would invent a substitute for rent as a factor in the economical organization of production. How land can be assigned to its most appropriate uses, as compared with labor and capital, except through the relative prices of these different elements, is a question of such difficulty as to have baffled some of the ablest of economic thinkers.